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The Economy and the Congress

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If Sen. Barack Obama is elected president of the United States, do you know what will happen to federal tax rates and government spending? If you answered "yes," then you have not been paying attention, because Mr. Obama and his advisers keep changing what they say they are going to do. Even more importantly, under the U.S. Constitution, Congress has the sole power to tax and appropriate funds, not the president. Congress always rewrites presidential tax and spending proposals, even when the president and congressional majority are of the same party, and hence no president gets to dictate fiscal policy.

The questions we should be asking are: What changes is Congress likely to make in the tax law, the level of spending, and energy policy if Mr. Obama is elected, and likewise if Sen. John McCain is elected? The accompanying table shows what happened to the economy during the past quarter of a century when each party controlled (or shared control of) Congress.

Control of Congress and the Economy

Control of Congress	Number of Years of Control 1983- 2007	Average Annual % Change in Economic Growth	Average Annual Deficit as a % of GDP
Republicans	11	+3.3	-1.0
Democrats	9	+2.8	-3.4
Divided	5	+4.1	-4.2

The economy had its best growth when the Democrats controlled the House and the Republicans controlled the Senate in the middle Reagan years, and when the Republicans controlled both the House and Senate during the last six years of the Clinton administration. The deficit was lowest, and the surplus occurred, when the Republicans controlled both houses of Congress under Democrat President Clinton. The Republicans foolishly threw away their hard-earned reputation for fiscal responsibility during the first few years of the Bush administration, and then the Democrats, rather than capitalizing on the Republican mistakes, increased the deficit even further since gaining power two years ago.

If the Republicans were smart, they would point out over and over again that President Clinton inherited an economy that was growing and left it in recession. The Republicans have the opportunity to go off defense, by pointing out that fewer people now lack health insurance than in 2000, during the last year of the Clinton administration, and that the economy is not, and has not, been in a recession but, in fact, grew at a respectable 3.3 percent during the second quarter of 2008.

The Bush tax cuts will expire in 2010, so the tax writing committees of Congress are going to be busy no matter who is elected. For instance, at various times, Mr. Obama has said he is in favor of raising the maximum capital gains tax rate from the current 15 percent to either 20 or 28 percent, but also eliminating the tax for small business start-ups. Mr. McCain favors retaining the current 15 percent rate, rather than letting it revert to the pre-Bush 20 percent. Thus, we know for certain that there will be a big debate in Congress over the capital gains tax rate. The forces of economic reason who understand that higher capital gains tax rates will result in loss of both tax revenues and jobs for Americans should be able to persuade the Congress that no matter who is president, it is suicidal to go to a 28 percent rate. Keeping the rate at 15 percent under President McCain will be easier than under President Obama, but will depend in either case on the resources the advocates of the 15 percent rate are willing to commit to the battle.

Mr. Obama has also called for increasing taxes on people making more than $200,000 per year, in order to "pay" for his various tax cuts and tax credit proposals and for all of the additional spending he has proposed. The problem is that the numbers just plain do not add up. Congress could apply a 100 percent tax rate on all income over $200,000 and they still could not get enough revenue to pay for all of Mr. Obama's proposed tax reductions and spending. (A 100 percent tax rate would, of course, bring in zero additional tax revenue because no one would be willing to work at those rates. In fact, the evidence is that the current maximum tax rates are already above the revenue maximizing rates so that any new significant revenue from raising rates is unlikely to occur). Given its past behavior, Congress is likely to pretend that it can get some revenue from raising tax rates, but is also likely to scale back some of Mr. Obama's proposed tax credit and rate cut proposals for lower income people, and cut back many of his proposed spending increases. Even so, Congress is likely to pass enough of his program to cause the economy to slow.

If Mr. McCain wins, he will probably be able to get Congress to extend most of the Bush tax cuts, particularly for low- and middle-income earners; but if Democrats control both houses, he will not have much ability to keep Congress from letting the top rate revert back to the 39.6 percent rate that existed when President Bush took office. Given recent history, it is reasonable to expect that the economic growth rate might be about 40 percent higher on average (4.1 percent vs. 2.8 percent) if the Republicans manage to capture either the House or the Senate.

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